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Transforming Class B and C Retail Centers: An Overview

Key Considerations for Repurposing, Repositioning and Redesigning

MARIA SICOLA and MARK STAPP***

Abstract: *This report discusses steps to be taken in increasing the value of an underperforming center. There is no "one-size-fits-all" approach to repositioning such properties, so the article concentrates on how to establish a framework for this process. It considers potential issues and roadblocks (e.g., aging infrastructure, public regulatory issues and building codes); the ranges of costs and timeframes required for a property turnaround; and the crucial role of research and due diligence. Key aspects of successful projects demonstrate how these principles can apply in practice.*

Much has been written about the changing retail sector and its impact on the bricks and sticks that house retail activities. These alterations are causing rapid obsolescence of existing B- and C-quality centers. Owners are often faced with answering the question "What can be done to increase the value of an underperforming center?" and the answer is not always a simple one. Numerous factors can affect the performance of aging shopping centers and influence strategies around transforming them. These include, but are not limited to: aging infrastructure, public/private regulatory issues, changing demographics and neighborhood composition, modified market preferences and

Lessons Learned

Collecting the right information and exploring all available options can decrease the inherent but necessary uncertainty involved with repositioning older/underperforming centers, as demonstrated in such areas as:

Research:

- Numerous research techniques can help identify factors that adversely impact center performance and the resulting reinvention strategies, including gap analysis, consumer focus groups, market share and demographic analyses, mall intercept and exit surveys, credit card sales data, omni-channel profiling and SEO (search engine optimization) tools such as BloomBerry which aggregate data from social media.
- Projects can be stalled or even derailed by unforeseen outside events, such as a global financial crisis, unexpected store closings and consolidations, mergers and acquisitions.
- Experts can supply much-needed advice in particular areas.

Critical factors:

- Design and materials from the initial construction of older centers need to be addressed, such as toxins that must be removed, structural systems that must be improved, and seismic upgrades that are required.
- Obtaining local jurisdictional approval of land-use changes, needed variances or redesign may involve working with officials to reverse size restrictions, resolve regulatory constraints, or secure financing.
- Before designing a repositioning strategy, identify all of the constraints related to private regulatory issues (e.g., lease terms or provisions banning certain changes or including non-compete clauses).
- Successful retenanting strategies may mean a shift to more local merchants—or, in the case of an increased food orientation, persuading lenders to accept non-credit tenants, or navigating zoning codes that conflict with greater parking demand.
- Obtaining agreement of all owners and stakeholders is essential before repurposing changes can proceed.

Successfully dealing with these matters requires expansive thinking, creative design and an open, out-of-the-box mindset, all of which are hallmarks of winning projects.

* Founder and CEO, Integrity Data Solutions, LLC.

** Professor of Real Estate, Executive Director of the Master of Real Estate Development Program and Director of the Center for Real Estate Theory and Practice, W.P. Carey School of Business, Arizona State University.

physical obsolescence, increased competition for shoppers, tired retail mix, emerging competition and ownership shifts.

Successful projects are nimble and have significant contingencies for the ever-changing business environment and unforeseen external factors and events including a global financial crisis, store closings and consolidations, mergers and acquisitions. These factors can stall projects or even derail them.

This article aims to establish a framework for strategic thinking about repositioning B and C centers by pointing out potential issues and roadblocks, to lend perspective to the ranges of costs and timeframes needed to turn a project around, and to highlight the importance of research and due diligence. Borrowing from experiential data and actual case studies, this report provides a road map highlighting key aspects of successful projects.

Importance of Research

Fundamental to any strategic plan is quality, reliable information needed for decision-making. Research plays a key role in identifying factors impacting center performance and the strategies needed to reinvent them. Numerous research techniques can be employed, including gap analysis, consumer focus groups, market share and demographic analyses, mall intercept and exit surveys and data gathered from Shopify apps like customer.guru.

It is also prudent to utilize *subject matter and/or product segment experts* in the specific area of advice that is required. For example, a traditional office owner/developer embarking on a retail project should work with a seasoned retail owner/developer. Similarly, before making a large-scale investment, it is wise to hire an investment advisory firm possessing the requisite experience. The questions that need to be asked and answered call for significant experience. The analysis requires understanding and evaluating numerous trade-offs and options.

Critical Considerations Affecting Repositioning

Owners must be willing to invest the capital often needed to transform these tired Class B and Class C centers. They must also be in sync with local government entities which play a role in zoning requirements. Zoning restrictions can make or break projects and orchestrating changes in them can delay timetable, adding significant costs. These factors can be further complicated by multiple owners. Critical issues typically faced include:

- *Aging infrastructure and environmental issues*: Many centers are old, which presents issues related to the design and type of materials used when they were initially constructed. Often toxic materials must be updated, structural systems need to be upgraded to support reconfiguration of space, or seismic upgrades are required, as well as accessibility improvements needed to comply with the Americans with Disabilities Act. Sometimes an older center may include highly desirable building design and material masked from years of upgrade, like stucco over brick or interesting and architecturally significant elements. Once the existing material is removed and the desirable elements unmasked, the design character emerges, helping differentiate the center.
- *Building and site configuration:* Often, older centers lack sufficient parking spaces, the buildings are configured in such a way as to make leasing difficult, or bay depths do not match market demands. The building configuration and site plan must be carefully studied, and repositioning may even require demolition of a part of the center in order to make it functional in the current and future market.
- *Public regulatory issues – building codes*: A major issue in repositioning is securing local jurisdictional approval of land-use changes, needed variances or redesign. If a local municipality has restrictions on structure sizes, for example, it may be necessary to work directly with officials to reverse them. Ample time should be allowed for discussions and negotiations around changing regulations. Rezoning to a higher and better use may prove difficult due to neighborhood objections. Sometimes a repositioning requires local political support needed to deal with critical issues and help resolve not only regulatory constraints but also help secure financing or provide public infrastructure improvements needed to support the repositioning plan.
- *Private regulatory issues*: Centers can be constrained by private regulations that make it difficult and sometimes impossible to make changes. These private restrictions include lease terms or provisions prohibiting certain changes or including non-compete clauses; cross-access and parking agreements which impact reconfiguration of parking and circulation; signage requirements; and parking and access agreements. Dealing with existing tenants can be expensive and time-consuming. Knowing all of the constraints before starting the design of a repositioning strategy is critical. Long leases associated with aging centers – often 10-20 years – can also make repositioning challenging as they have a direct impact on timing and cash flow.
- *Changing development patterns*: A center can lose value because its context has changed due to community expansion or decline. What once was a major intersection may no longer be. Especially in growth markets, development patterns can shift, leaving a once-thriving center in a location that is less desirable to tenants. Knowing where an area is in its lifecycle is important. Sometimes the desirability simply means the highest and best use of property is no longer retail or considerably less retail.
- *Changing demographics and neighborhood composition*: While demographic shifts have always played a part in crafting the optimal mix of stores, with aging baby boomers and millennials converging, this has never been more important and complicated than it is today. Combine this with the growing popularity of omni-channel marketing and the challenges become not only what retailers want for store formats but also what other types of uses–medical, education, entertainment – may make the most sense going forward.
- *Increased competition for shoppers:* Many times it is the relative location that changes. As neighborhoods and areas mature, locational attributes of older centers may decline.

Newer centers maybe better located and/or designed, attracting tenants and users alike, capturing more demand.

- *Tired retail mix*: As consumers' behaviors and tastes change, tenant mix may lose its desirability. Knowing trends and market position is needed so a re-tenanting strategy can be created. Shifting to a local merchant tenant mix may be warranted. The current trend toward food-focused tenant mix also means challenges in lender acceptance of non-credit tenancy and increased parking demand that conflicts with zoning codes.
- *Lender Conflicts*: Often ownership is constrained by lenders who are reluctant to allow major or wholesale changes needed for repositioning. Loan documents may require lender consent. As mentioned above, lenders may object to changing tenant mix to less credit and more locally driven and contextual uses. Lenders are essentially a partner in the decision to reposition.
- *Ownership shifts*: Sometimes who owns the center and how it is owned can impact decision-making. If ownership cannot, or is not, in agreement on needed changes, making the required difficult decisions may be impossible. Any plan must have all owners and stakeholders in agreement. Centers that have been foreclosed and managed by third-party asset managers often cannot make the needed changes due to lack of funds, lack of local knowledge or misaligned incentives.

Highlights from Successful Projects

A series of "Turning Point" articles by Bill Speer and published in ICSC's *Retail Property Insights* from 2015 to 2017 provide excellent examples of these repositioning challenges. The case studies in these articles also contain solutions crafted from the checklist findings. Summary profiles for two centers, The Shops at Nanuet and Rivers Edge, are in the tables that follow, which contain key elements of the "before and after" scenarios, highlighting the measurements of success.

Conclusion

Repositioning any asset is a difficult proposition and changes in the retail segment make B and C centers more difficult. It is important to realize that real estate is a local asset and derives its value from this context. Knowing the local market and context of an asset is crucial in making good decisions about how to reposition a center. The right answer requires an intimate knowledge of local needs; it is not formulaic. There is a process to follow which includes:

- Assembling the right team of professionals to assess the market and center and to design a strategy for repositioning.
- Making sure there is organizational competency and capacity to carry out a defined strategy.
- Resolving ownership and lender conflicts and securing approval to make needed changes.
- Clearly defining explicit objectives and communicating these to the team members.
- Carefully defining indirect and direct costs including sufficient contingency for unknowns and delays.
- Knowing the local market and developing a segmentation analysis to identify target markets and gaps in supply of goods and services to the target market.
- Developing a realistic understanding of the scope and schedule and communicating these to all decision-makers, investors and lenders.

Dealing with these issues and formulating a strategy requires owners to pursue expansive, creative and out-of-the-box thinking and design, all of which are hallmarks of winning projects.

Table 1
The Shops at Nanuet (Nanuet, NY)

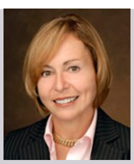
KEY FACTORS	LEGACY	REPOSITIONED
Ownership	Homart 1969 / Corporate Property Investors 1979	Simon Property Group 1998
Competitive Challenges	Limited competition until Palisades Center opening in 1998	2013: Apple relocated from Palisades Center
Retail Mix	Anchors: Macy's, A&S, Sears	Macy's, Sears, Regal Cinemas, Fairway Market, 24 Hour Fitness, Michael Kors, Bonefish Grill
Regulations	Wetland concerns	Streamlined approval process for permits and wetland mitigation; $31 million sales tax exemption for construction materials
Total Center Sales / Tax Revenues	2007: Sales $110 Million; 67% Occupancy Rate	2015 Sales $160 Million; 10% increase in tax revenues in Rockland County / 96% Occupancy Rate
Timeframe for Redevelopment	Planning started 2003; announced Feb. 2008; closed, let leases expire, May 2008; stalled by Great Recession until 2011	March 2013: construction begins; October 2013: grand opening
Design	Enclosed two-level mall; 1969: 675,000 square feet; 1995: 1,000,000 square feet	Reviewed 20-30 schemes, then cleared the site; 750,900-square-foot open-air center; won 2015 ICSC U.S. Design and Development Award for Renovations and Expansions

Source: Bill Speer, "Turning Point: Nanuet Mall's Transformation Into Shops at Nanuet Responds to Increased Competition," *Retail Property Insights*, Vol. 23, No. 2, 2016–2017.

Table 2 Rivers Edge (Indianapolis, IN)		
KEY FACTORS	LEGACY	REPOSITIONED
Ownership	1989: Sourwine Real Estate Services (office developer)	2008: Kite Realty Group (retail developer) acquired center for $18.3 million
Competitive Challenges	2007: 25% Non-anchor space vacant	Significant adjacent development
Retail Mix	Office Depot	buybuy BABY, The Container Store, Nordstrom Rack, Harry & Izzy's Steakhouse
Regulations	Reclaimed land from flood plain / landfill / 20-foot retaining wall, engineered fill, concrete piers needed	Rezoning application to add 60,000-square-foot anchor and outdoor seating
Total Center Sales/Taxes	2010: 20% occupancy rate	2012: fully leased; 2014: $65 Million; 2015: NOI 4x 2010 levels
Timeframe	2010: Announced $15 million redevelopment	Fall 2011: Redevelopment completed
Design	110,000-square-foot community center anchored by Office Depot	Demolition, new facades, new signage, landscape improvements precede opening of 153,000-square-foot community center

Source: Bill Speer, "Turning Point: Rivers Edge Revitalization Catalyzes Development in Surrounding Area," *Retail Property Insights*, Vol. 23, No. 1, 2016.

Repositioning is risky and uncertain. Repurposed centers may simply be redesigned, tenanted and marketed or they can be converted to mixed-use design projects that include a variety of uses: residential, entertainment, medical offices and gyms. Often there is no single right answer, but regardless how difficult, pursuing these projects as complex problems and taking the time to collect the right information and exploring the options will result in a higher likelihood of financially successful repositioning and a higher value asset.



Maria Sicola is the Founder and CEO of Integrity Data Solutions, LLC. As a leader in the commercial real estate industry she has over 30 years of experience providing strategic market intelligence and innovative solutions for clients while directing large, high-achieving cross-functional teams. Ms. Sicola's work has focused on real estate market analysis, forecasting and site selection. She has collaborated with academic institutions such as George Washington University, University of North Carolina and University of Pennsylvania and is a frequent speaker at industry conferences, including those held by Urban Land Institute (ULI), NAIOP, and The Commercial Real Estate Network (CREW). Ms. Sicola earned an M.B.A. from Manhattan College, and a Master's Degree in Information Science from Rutgers University, completed post graduate studies at Purdue University and earned a B.A. from Seton Hall University. For further information related to this article, she can be reached at: maria@integritydatasolutions.net.

Mark S. Stapp is the Fred E. Taylor Professor of Real Estate, Executive Director of the Master of Real Estate Development Program and Director of the Center for Real Estate Theory and Practice in the W.P. Carey School of Business at Arizona State University. He also serves as a faculty associate in the School of Architecture and Landscape Architecture in the Herberger Institute for Design and the Arts at ASU. In November 2011 Mr. Stapp was named a Distinguished Fellow of NAIOP. He currently serves on the local boards of ULI Arizona, Local Initiatives Support Corporation Phoenix (LISC) and Valley of the Sun YMCA where he chairs the Facilities Committee. He is a member of the Provosts Advisory Council for Arizona School of Health Sciences and Oral and Dental Health, serves as co-chair of the Academic Research Committee of International Council of Shopping Centers and is a member of ICSC's North American Research Task Force.

Mr. Stapp is the Managing Member of Pyramid Community Developers, LLC, an investment and development firm of projects throughout the US and provider of asset management and design consultation services. He is an active member of the Phoenix development community, where he has been part of various business enterprises and development projects across the North America for over thirty eight years. Mr. Stapp was President, US operations, Naef International Management, a Swiss Investment from 1995 to 2007. From 1990 to 2000 he served as Chairman of the Board of Taliesin Associated Architects, the successor studio of Frank Lloyd Wright, and founded and operated First City Homes, a Phoenix-based homebuilder which he sold in 1998. He was Vice President of Planning and Development Services for Lendrum Design Group, served as Managing Director of Mountain West Research and was Senior Vice President of The Ellman Companies.

Mr. Stapp completed his undergraduate work in environmental studies and urban design at William Paterson University, and did his graduate work in urban economics at Arizona State University and the Stanford University Graduate School of Business Executive program. In 2007 Mr. Stapp received a Doctor of Humane Letters from A.T. Still University, for his work in community sustainability, health and wellness. For further information related to this article, he can be reached at: Mark.Stapp@asu.edu.